This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 02 KATHMANDU 000495

SIPDIS

SENSITIVE

SA/INS
SINGAPORE FOR FAA

E.O. 12958: N/A
TAGS: EAIR ECON NP
SUBJECT: HEMORRHAGING FROM ON HIGH: COMMISSION RECOMMENDS PARTIAL PRIVATIZATION OF ROYAL NEPAL AIRLINES CORPORATION

REF: 01 KATHMANDU 0741

SUMMARY

¶1. (SBU) A commission has recommended the partial privatization of the state-owned national air carrier Royal Nepal Airlines Corporation (RNAC) to inject fresh, badly needed capital into the teetering enterprise and to limit the political interference that has bled the once profitable Corporation dry. There is considerable skepticism that the Government, which has long regarded the airline as an easy way to distribute political patronage, will agree to cede the management of--and the milking of--a cash cow that is quickly drying up. End summary.

ROYAL NEPAL: IN THE RED

¶2. (U) State-owned national air carrier Royal Nepal Airlines Corporation (RNAC), established in 1957, is now running at losses estimated at more than USD 2.5 million a year and carries just under than USD 34 million in debt and liabilities. Of the nine planes in its inventory (two Boeing 757's for international and seven Twin Otters for domestic routes), only the Boeings and four of the Twin Otters are operational. The airline stopped its service to Europe in the summer of 2001 and now flies only 63 hours a week on its limited international routes to India, Bangkok, Hong Kong, Osaka, and Shanghai. A well-earned reputation for mismanagement, poor service, and inconvenient scheduling had been constricting RNAC's ever-shrinking share of the market over the past several years. The double whammy of September 11 and increased Maoist violence, which has sliced into tourism revenues across the board (arrivals in February declined by 46 percent compared to last year), has further deepened RNAC's financial troubles.

¶3. (SBU) Unfortunately for the GON, the Act that established the RNAC holds the Government liable for any and all losses sustained by the Corporation. Should the RNAC fail--and one press report alleges the airline needs an immediate infusion of USD 25 million to stay afloat--the GON would be left holding the bag. The Finance Minister, to avert an impending disaster, pushed the Cabinet in January to appoint a high-level committee, headed by former Chief Secretary and former Ambassador to the U.S. Damodar Gautam,

SIPDIS
to review the airline's financial health and make recommendations for its future. The Committee completed its report February 15 and forwarded it to the Ministry of Tourism and Civil Aviation for review.

PRIVATE INVESTMENT IS NEEDED

¶4. (SBU) The report recommended a number of fairly drastic changes in RNAC operation, ownership, and management. First, recognizing that the GON is in no position to provide investment capital for the airline,it recommended that the domestic and international services be split into two separate companies. Management and partial ownership (the report recommends about one-third) in the international airline should be offered to a private investor (likely a foreign airline); one-third to other investors (tourism businesses; financial institutions; airline employees; and the general public) and the rest maintained by the GON. The Corporation should trim its staff of 1,836 by about half, and sub-contract out for a number of services (security guards, drivers, etc.) that permanent staff now performs. RNAC should sell off unused inventory and other assets to provide more immediate cash flow. Bookkeeping should be improved. (Note: RNAC has not been audited since 1998. End note.) Aircraft should be leased directly from the manufacturer and not from agents. Assets should be re-valued and the terms of repayment of the company's debts renegotiated. A marketing

survey to determine the most profitable routes and schedules should be performed. In conclusion, the report bluntly highlights the key problem with RNAC: "too much political interference" and decision making on the basis of "political patronage."

¶5. (SBU) Nagendra Prasad Ghimire, a Joint Secretary at the Ministry of Tourism and Civil Aviation who sat on the Committee, told econoff that since chronic "political interference" brought the airline to its present sorry state, it was decided to recommend increasing and diversifying the base of ownership. The Committee wants and is recommending an internationally recognized airline as a strategic partner for RNAC. One-third equity participation is a minimum for the private investor to take over management and operation of the company; the percentage "could be more" depending on the investor's interest, Ghimire said. He described the report's recommendations as "very bold," and acknowledged getting agreement from all the relevant line Ministries and the Cabinet will take some time.

POLITICAL MEDDLING ISN'T

¶6. (SBU) Amb. Gautam believes the airline began its decline over the past 12 years, when he says it began awarding leases and other contracts on the basis of political influence rather than competitiveness. Aircraft was not leased at the right time at the right price because the decision-makers' motivation was "different" from what it should be. For example, an Airbus leased from Europe under unfavorable terms from 1993-1995 cost the airline USD 2.2 million in 22 months. He noted as well the controversial award of a leasing contract for a Lauda aircraft in 2000 (for about USD 25 million over 18 months) that bypassed normal bidding procedures (and, many believe, contributed to former PM Koirala's decision to resign). Contracts for General Sales Agents overseas were also awarded on the basis of political pressure, he said, noting the infamous case of a ticket agent in Vienna who disappeared with more than USD 1 million in RNAC revenus in 1995. The culture of corruption has become so pervasive that it infects not only the highest levels but extends down to domestic ticket agents who accept bribes to say a half-empty flight is full. Political leaders view the Corporation as their own personal fiefdom, he indicated, noting that RNAC has changed CEO's (12 in 12 years) with just about as much frequency as the Nepal has changed Prime Ministers.

COMMENT

¶7. (SBU) That RNAC has been teetering on the brink of bankruptcy for some time now (Reftel) does apparently little to deter the political leadership from continuing to milk this floundering state-owned enterprise completely dry. The Committee completed its report in less than the six weeks allotted it for the task; whether the Cabinet will complete its own review of the recommendations as quickly seems unlikely. Unfortunately, at a time when embattled Prime Minister Sher Bahadur Deuba needs all the friends he can get, depoliticizing and privatizing a long-favored channel for patronage may figure low on his immediate agenda.

MALINOWSKI